The Honorable Dave Reichert
US House of Representatives
Washington DC 20515

The Honorable John Lewis
US House of Representatives
Washington DC 20515

April 15, 2013

Dear Representatives Reichert and Lewis:

Thank you for your continued work on reviewing the law concerning charitable deductions. The Land Trust Alliance wants to pass along some of our observations on the questions you posed to those speaking at your forum on April 10th.

The Land Trust Alliance represents 1,200 501(c)(3) publically-supported charities that work with private landowners on conservation of lands.

- How do current property valuation rules affect the tax-exempt sector?

There is no question that allowing deductions for the fair market value of appreciated property is a very valuable incentive for charitable giving. And in the case of **donations of property which, in and of themselves, forward a charitable cause** – a work of art to an art museum, a Stradivarius to an orchestra, a valuable wildlife habitat to one of our land trusts – this incentive is very effective in getting charities exactly what they need.

Land trusts – charities that work on land conservation – depend on gifts of land and conservation easements, and the valuation of those gifts is a critical element in any landowner's consideration of whether to donate. These are very valuable gifts – the IRS Statistics of Income office says say the average value of a gift of land is $170,000, and the average value of a conservation easement on land (a restriction on future development to protect important conservation values) is about $460,000.

These are gifts that advance our charitable purpose in themselves. We don't want to sell them to provide funding for our other activities and in most cases could not do so without violating donor intent (which would violate every state's charity laws).

We understand that great care and some expense will be required to substantiate the value of such gifts, and understand and accept that a donor must pay $5000 and up for a qualified appraisal for them. Even so, the current system has led to about 1 million acres a year of conservation easement donations, and significant additional donations of land for parks, preserves, community gardens, and other valuable public purposes.

In short, land trusts as charities are very dependent on the rules for valuation, and we are very dependent on those rules working well.

- Is it possible to correctly value property?

The federal government buys property all the time (as do state and local governments). They purchase real property (real estate) for roads, for schools, for parks, and a host of other purposes. In each of these cases, government pays a price set on the basis of a professional appraisal. Generally, federal and state laws prohibit government paying more than the appraised value for real property, and federal law requires federal agencies to offer any landowner the full fair market value for their land.

Appraisals are used to set the value of billions of dollars of property a year for acquisition or condemnation by governments. Can appraisals be an appropriate way to set the value of donations? The answer is clearly yes.

- Are the changes in the appraisal rules in the 2006 Pension Protection Act (PPA) effective?

The PPA made a number of changes to the rules. Some were specific to specific donations (such as used cars) that have not been a major part of donations to land trusts. Other, more generic rule changes do affect land conservation and many other charitable endeavors.

The PPA changed the **definition of who is qualified to submit an appraisal for tax purposes**. Prior to the PPA, anyone who was in the business of providing appraisals was qualified to do appraisals to substantiate tax deductions. The PPA **required that the appraiser have specific education and experience in appraising the type of property they appraised**. The PPA also changed the definition of a "qualified appraisal" so that it was required to follow "generally accepted principals of appraisal".

Although the IRS issued Notice 2006-96 on these issues and issued Proposed Regulations in 2008 (See IRS Bulletin 2008-40), the proposed regulations have no force of law, leaving many of the finer points of the PPA changes to the definition of who is a qualified appraiser and what constitutes a qualified appraisal up in the air.

Encouraging the IRS to finalize those regulations would be very helpful in ensuring that IRS agents, IRS Appeals officers, and the courts have clear definitions that will help the IRS and the courts enforce meaningful qualifications for appraisers and appraisals.

The PPA language specifying that an appraiser must demonstrate expertise and experience in the valuation of the specific type of property they value for tax purposes (see section 170(f)(11)(E)(iii) of the PPA) led to a cooperative agreement between the Land Trust Alliance and the Appraisal Institute that resulted in development of a 5-day training course on appraising conservation easements leading to the award of a certificate to appraisers who have taken the course and passed an examination on its content.

It is valuable to look at the experience of the State of Colorado in dealing with abusive valuations of conservation easement donations (with respect to the state's own state income tax credit for such donations). They effectively stopped abuses by withdrawing state appraisal licenses from abusive appraisers, based on their appraisals violating USPAP (Uniform Standards of Professional Appraisal Practice – which all real estate appraisers are required by state law to comply with). Frankly, **we would like the final regulations to require that taxpayer appraisals of real property conform to USPAP,** as federal banking law requires for appraisals for mortgages. (**Note: the IRS proposed regulation do not require strict compliance with USPAP**). Requiring compliance with USPAP would allow the IRS to disqualify unprofessional appraisals **because they are unprofessional** – which could avoid an expensive and time-consuming challenge of <u>valuation</u> (as opposed to <u>appraisal practice</u>), which often comes down to dueling appraisals by the IRS and the taxpayer.

The PPA tightened the definition of misvaluation and gross misvaluation.

Under former law, a substantial misstatement was a value claimed that was at least twice (200%) the amount determined to be correct, and a gross misstatement was at least four times (400%) of the correct value. A taxpayer would not be subject to any penalty, however, if (1) the value claimed on the return was supported by substantial authority; (2) the facts involved are disclosed on the taxpayer's return and there is a reasonable basis for the claimed value; or (3) the taxpayer could show that there was a reasonable cause for the undervaluation and the taxpayer acted in good faith.

The PPA lowered the threshold for the degree of misstatement that invokes penalties. Now, a substantial misstatement means one that is 150% or more of the amount determined to be correct, and a gross valuation misstatement means that the claimed value is at least 200% of the correct value. In addition, the "reasonable cause" exception no longer relieves a taxpayer from penalties in cases of gross misstatements of value.

The penalties for the taxpayer remain the same: 20% of the underpayment of tax for a substantial misstatement, and 40% of the underpayment for a gross misstatement.

Lastly, the PPA added a new category of penalties for appraisers whose valuations are found to be substantial or gross valuation misstatements, under section 6695A of the Code (the prior penalties were under sections 6700 and 6701). Under prior law, appraisers were subject to penalties for aiding and abetting understatement of a donor's tax liability under section 6701 of the tax code. The penalty was generally $1,000.

The amount of the new IRC section 6695A penalty is the lesser of:

A. 10 percent of the amount of the underpayment (defined by IRC 6664(a)) attributable to the misstatement, or $1,000 (whichever is greater); or,
B. 125 percent of the gross income received from the preparation of the appraisal.

Together, these changes can be very effective in creating a deterrent to misvaluation, but their effect has been slow to be seen, partly because of how slowly the audit/Tax Court system works. It is routine for tax disputes on valuation to run 5-10 years or more before final resolution, and hundreds of cases from before the passage of the PPA in 2006 are still awaiting final decisions.

These penalties have increased the stakes for taxpayers in a way we believe is fair. They have also increased the stakes for an appraiser, which has driven up the cost of appraisals and is making it harder to find appraisers willing to do this work. It remains to be seen how it will affect the ability of taxpayers to obtain a qualified appraisal of donated real property in the future.

The appraiser penalties do raise important issues of process and fairness. When the IRS asserts penalties against an appraiser, it severely handicaps their ability to continue their business. But if it takes years to finalize a verdict, the punishment clearly precedes the judgment.

- Do some of the current rules discourage giving?

Clearly, rules can discourage giving if they are onerous. The rules referred to above do not discourage donors of ours who believe they are doing the right thing.

But **the IRS audit process does discourage giving**. We do not see the present selection of returns for audit as focused enough to capture most abuses, or to avoid capturing many well-intentioned donors. The process that follows (in which the burden of proof is on the taxpayer) is unfortunately often adversarial and carried out by unspecialized IRS personnel – that is, the audit is initiated by an agent who often has little or no experience in what is, in the case of conservation easement donations, a highly technical and nuanced area.

In the area of conservation easements, agents' reaction to highly technical legal issues has often been to start with a blanket assertion to the donor that their very valuable donation is worth nothing, even before consultation with the IRS valuation specialists, necessitating a lengthy and expensive process of completing the audit and going to the IRS Office of Appeals, and sometimes to Tax Court or federal district court, to correct. Taxpayer costs for that process are rarely if ever recovered from the IRS.

Not surprisingly, well-intentioned donors often react quite negatively to an adversarial, lengthy and expensive audit process as the consequence of making a very generous gift of what is often their family's most valuable asset. We are hoping to work with the IRS to see if this process can be improved, or if an alternative to the current process can be constructed, as was done for donors of art by the creation of the IRS Art Advisory Panel in 1986.

Another unintended result of the law and regulations has been the total disqualification of large donations from any deduction because of "foot faults" – failure to comply with one of many technical requirements for substantiation. A donation was invalidated by the IRS because the appraisal summary form was signed by only one of the two appraisers who worked on the appraisal.

Other donations that everyone acknowledges were made and were valid were found to not qualify for any deduction because the donor could not produce a contemporaneous letter from the donee acknowledging receipt of the gift from before the tax return was filed. The use of these "foot faults" to disqualify otherwise legitimate charitable contributions may be legally correct, but it may not be just, and the injustice is magnified in the case of a million dollar contribution. This may be a place for the Congress to allow for intermediate sanctions that penalize a failure to strictly comply with the law without denying all benefits to a charitable gift that clearly was made.

Thank you again for all your hard work on the tax issues surrounding charitable donations and nonprofit enterprises.

Sincerely,

Russell Shay

Russell Shay
Director of Public Policy
Land Trust Alliance